INVESTMENT INDUSTRY ASSOCIATION OF CANADA
ASSOCIATION CANADIENNE DU COMMERCE DES VALEURS MOBILIÈRES

Susan Copland, B.Comm, LLB.
Director

Jamie Bulnes
Director, Member Regulation Policy
Investment Industry Regulatory Organization of Canada
Suite 900 – 145 King Street West
Toronto, ON M5H 1J8
jbulnes@iiroc.ca

Manager of Market Regulation
Ontario Securities Commission
Suite 1903 Box 55
20 Queen Street West
Toronto, ON M5H 3S8
marketregulation@osc.gov.on.ca

July 13, 2009

Dear Sirs/Mesdames:

Re: Proposed Amendments to Dealer Member Rule 1300.1 – Trading in Securities of US OTC Issuers

The Investment Industry Association of Canada (IIAC) appreciates the opportunity to comment on this initiative. As you are aware, many of our members have been subject to the BCSC's conditions of registration ("BC Conditions") over the past year, and our comments are informed by their experiences with those requirements, as well as the feedback from our other members who will be affected by the rule.

The IIAC supports the objectives of the BC Conditions and the proposed IIROC amendments. It is in the industry's interest to ensure the abusive activities prevalent in the OTC markets do not cause harm and reputational damage to the Canadian markets. Notwithstanding that the majority of the problems appear to be concentrated in British Columbia, it is essential that the regulatory regime designed to deal with these issues be national in scope, to ensure the activities are curtailed, and do not merely relocate to jurisdictions without such regulation. Further it is important that the regulation is consistent across all jurisdictions to avoid the complexities and confusion that result when firms operating in different jurisdictions are subject to different identification, monitoring, supervisory and reporting requirements. Regulatory inconsistency is

particularly problematic for the increasing number of firms with operations in multiple jurisdictions.

Although the objective of the proposed regulation is sound, we believe that a more focused approach can achieve the intended results more effectively and efficiently. In practice, the BC Conditions on which the IIROC amendments are modeled, have proved to be too broad in their reach due to the limited definition of exempting exchanges. A number of large and reputable issuers such as General Motors, Louis Vuitton, Heineken and the Royal Bank of Scotland currently trade OTC and may be listed on non-North American stock exchanges without a corresponding listing on a North American stock exchange. Although the regulation was not intended to apply to trades in such large, publicly traded issuers, the consequence of the broad definition of OTC issuer is that firms are required to ascertain the beneficial ownership of all investors trading in these securities, including pension funds, mutual funds and other institutional investors. Ascertaining beneficial ownership down to the individual level of such institutions is often not possible, and is not relevant to the regulatory intent of the provisions. The effect of this improperly focused regulation is that firms that do not undertake any of the business that is of concern to the regulators must perform time consuming and inefficient practices to isolate non abusive OTC trades, identify the beneficial owners (where possible), and report to the regulators. This issue can be addressed by expanding the list of exempting exchanges beyond North American marketplaces. Concerns with exchanges located in secrecy jurisdictions could be addressed by limiting the criteria for exempting exchanges to those located in Basel Accord jurisdictions.

In order to properly target the problem without creating unintended negative consequences for legitimate transactions, the proposed rules should be focused on individual investors and small corporate/shell companies, and should not apply to Canadian registered money managers, pension funds, mutual funds, publicly listed issuers or other similar institutions. We recognize that foreign firms in secrecy jurisdictions are being used to conceal the identities of problem individuals, but in the case of registrants, institutions and publicly traded issuers that are domiciled or listed in Canada, it should not be difficult to obtain the relevant information to ascertain legitimacy.

Logistically, the requirement to stop every OTC order before a trade occurs is very problematic for clients, and operationally difficult to implement. It is not practical to electronically monitor for OTC securities deposited in clients' accounts since they do not carry a unique identifier. As a result, it is a significant challenge to generate and maintain a current list of the applicable securities that must be reviewed before a sale takes place. Requiring firms to obtain this information prior to the sale does not provide regulators with any additional information than if the firms simply report the buy/sell data and comply with the "know your client" requirements that are already in place. The proposed amendments would require firms to revert to manual processes, which requires significant time and resources, and as with any manual process, will be prone to errors. In addition, delays in selling transactions may create market risk and possibly leave dealers exposed to civil liability where losses occur.

In order to accomplish the goals of the regulation without the unintended consequences, IIROC should not simply extract sections of the BC Conditions, which have demonstrated problems. It is important to focus the regulation on the high risk activities, such as OTC trading by off-shore banks or institutions on behalf of individual clients or

small corporations, where there is an inability to document ownership of such accounts or where clients provide physical certificates with or without legending. Rather than creating a new regulatory regime, IIROC should consider enhancing IIROC Rule 2500, *Minimum Standards for Retail Account Supervision* to require increased due diligence when dealing with high risk markets and suspicious trades. This could be accomplished by adding provisions to Rule 2500, similar to what is contained in UMIR 2.2 *Manipulative and Deceptive Activities,* with a particular focus on transactions involving physical certificates, types of manipulative trading activity and high risk persons such as the insiders and control persons of the issuer.

If IIROC elects to use the BC approach, we believe the following adjustments are necessary to properly focus the regulation to target the activities of concern, while minimizing the regulatory over-reach.

1. Set a threshold for identification of beneficial ownership that is consistent with the 10% standard adopted in Bill C-25, Proceeds of Crime (Money Laundering) and Terrorist Financing Act.

2. Include a reasonable diminimus trade value exemption, on a per day, per week and cumulative basis. When the trades exceed these amounts, the requirements would be triggered.

3. Provide a diminimus volume exemption to facilitate the sales of negligible volume or value positions.

4. Provide a specific exemption for agency sales for registrants (investment counselors, portfolio managers and mutual funds), regulated pension funds, companies listed on the IIROC AI/AC list as published from time to time, and listed issuers selling OTC securities.

5. Provide an exemption for domestic corporations where any one person having a 10% or more interest in the corporation is already disclosed on the account

6. Amend the definition of an OTC security to exempt those security positions that are inter-listed/quoted between the OTC market and another foreign, recognized, regulated marketplace (i.e. the ASX or the AIM) or in the very least exclude those positions in those securities where the sale is executed on that foreign regulated marketplace. It is unclear how this rule could apply to sales on a foreign market, and as such, the restriction on trading on US markets does not appear to achieve the objective of the rule.

7. Provide guidance on what the IIROC would deem as constituting the documentation of beneficial ownership of foreign corporate accounts. Depending on the jurisdiction of incorporation, it may not be possible to obtain any corporate documentation evidencing the shareholders of the corporation; as there may be no corporate shareholder list or corporate record of who owns the shares of the corporation. Such guidance would, of course, take into account KYC and AML requirements

Regardless of the approach that is taken, IIROC and the BCSC should work together to develop a harmonized regime to ensure regulatory consistency, and avoid undue

complexity and the likelihood of regulatory arbitrage that can take place where standards differ among jurisdictions. Ideally, the BC Conditions should be repealed for IIROC dealers operating under the proposed regime.

Thank you for considering our comments. If you have any questions please do not hesitate to contact me.

Yours sincerely,

Susan Copland